

HOUSE BILL REPORT

HB 1142

As Reported by House Committee On:
Commerce & Labor

Title: An act relating to prohibiting pyramid promotional schemes.

Brief Description: Prohibiting pyramid promotional schemes.

Sponsors: Representatives Chase, Conway, Pettigrew, Skinner, Ormsby, Condotta, Kessler, Armstrong, Linville, Eickmeyer, Morrell, Kenney and Santos.

Brief History:

Committee Activity:

Commerce & Labor: 1/23/06 [DPS].

Brief Summary of Substitute Bill

- Prohibits establishment, promotion, operation, or participation in pyramid schemes.
- Makes a violation of the prohibition a violation of the Consumer Protection Act.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 8 members: Representatives Conway, Chair; Wood, Vice Chair; Condotta, Ranking Minority Member; Chandler, Assistant Ranking Minority Member; Holmquist, Hudgins, Kenney and McCoy.

Staff: Chris Cordes (786-7103).

Background:

According to the U.S. Securities and Exchange Commission and the Federal Trade Commission, classic pyramid schemes involve investors making money solely by recruiting new participants into the program. The schemes may be disguised to look like legitimate multi-level marketing programs, but with a promise of high returns for simply paying and recruiting others to pay. Under these schemes, only a few early stage investors receive payments as the scheme collapses for lack of new recruits. Most states prosecute pyramid schemes under either the state's Consumer Protection Act or specific laws prohibiting pyramid schemes. In 2004 the Council of State Governments, in conjunction with the Federal Trade

Commission, developed and adopted a model bill prohibiting pyramid schemes that has been adopted in a number of states.

In Washington, chain distribution schemes are specifically prohibited. Under this law, the scheme is illegal if a person makes an investment to obtain the right to recruit others into the program. Limits, such as the number of participants or the right to receive profits, do not change the identity of the scheme.

A violation of the chain distribution scheme statute is a violation of the Consumer Protection Act (CPA). Under the CPA, a court may impose civil penalties on a perpetrator in the amount of \$2,000 for a general violation and/or may order an injunction, the payment of court costs and attorney fees, an injunction, or other necessary remedies.

Summary of Substitute Bill:

The Legislature finds that pyramid schemes, chain letters, and related illegal schemes are enterprises that finance returns through sums taken from newly attracted participants who are promised large returns for their investment and involve unfair tactics, such as misrepresentations of sustainability and legality.

Establishing, promoting, operating, or participating in a pyramid scheme is prohibited. A violation of this prohibition is a violation of the Consumer Protection Act.

A pyramid scheme is defined as a plan or operation in which a person gives consideration for the right or opportunity to receive compensation that is derived primarily from the recruitment of other persons as participants in the plan or operation, rather than from the sales of goods, services, or intangible property to a person or by persons to others. Consideration means the payment, however characterized, of cash or the purchase of goods, services or intangible property. However, consideration does not include purchases at cost to be used in making sales, the time and effort spent in pursuit of sales, or purchases that are subject to a bona fide repurchase agreement.

A repurchase agreement is an enforceable agreement by the seller to repurchase, at the buyer's request, all currently marketable inventory within one year from its date of purchase at not less than 90 percent of the original net cost, less consideration received by the buyer. Products are not currently marketable if they are returned for repurchase after the commercially reasonable usable or shelf life of the product, or if it has been clearly disclosed to the buyer that the products are seasonal, discontinued, or special promotion products.

Limitations on the number of participants or eligibility conditions does not change the scheme's identity. It is not a defense that a person giving consideration obtains goods or services in addition to the right to receive compensation, nor that the consideration is designated as a gift or donation.

The law regarding chain distributor schemes is repealed.

These provisions may be cited as "the Antipyramid Promotional Scheme Act."

Substitute Bill Compared to Original Bill:

The substitute (1) adds an intent section with findings about pyramid schemes as illegal enterprises; (2) deletes a requirement for participation to be "knowing" to find a violation; (3) revises the definition of "consideration" to add that it also does not include the purchase of goods or services subject to a bona fide repurchase agreement and removes references and requirements related to inventory loading and inventory repurchase programs; (4) adds that limitations on the number of participants or eligibility conditions does not change the scheme's identity; (5) adds that it is not a defense that the person giving consideration obtains goods or services in addition to the right to receive compensation, nor that the consideration is designated as a gift or donation; and (6) adds that these provisions may be cited as "the Antipyramid Promotional Scheme Act."

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: This bill is important to many small home-based businesses, many of whom are women, who need clear protections and a clear line to know what are legitimate business practices. This bill encourages good inventory repurchase plans, which helps these small business who might otherwise be stuck with a garage full of inventory. The bill will protect the public from pyramid schemes that operate under the guise of selling new memberships, but only hurt those at the bottom. This bill provides a new tool for enforcement against these illegal schemes. It is important to get the protections of the Model Act in place.

Testimony Against: None.

Persons Testifying: Representative Chase, prime sponsor; Misty Fallen, Direct Selling Association; Mark Johnson, Washington Retail Association; Crayton Webb, Mary Kay, Inc.; and Brian Harrison, Alticor.

Persons Signed In To Testify But Not Testifying: None.